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## Your Forum or Mine - Where to Arbitrate Investor-Broker Securities Claims

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## COMMENT

# YOUR FORUM OR MINE? WHERE TO ARBITRATE INVESTOR-BROKER SECURITIES CLAIMS

### I. INTRODUCTION

The Supreme Court's recent decision in *Rodriguez de Quijas v. Shearson/American Express, Inc.*,<sup>1</sup> coupled with its decision in *Shearson/American Express, Inc. v. McMahon*<sup>2</sup> two years earlier, has made all Securities Act claims and RICO claims arbitrable if a broker and its customer enter a valid pre-dispute arbitration agreement.<sup>3</sup> However, a nettlesome problem faces both customers and brokers in the wake of the Court's recent decisions: what is the appropriate forum for customer-broker arbitration?<sup>4</sup>

Customers have traditionally chafed at arbitrating their claims in front of panels sponsored and subsidized by the securities industry,<sup>5</sup> but the vast majority of all customer-broker arbitrations take place in these forums.<sup>6</sup> Brokerage houses, on the other hand, are leery of arbitrating before the American Arbitration Association (AAA), a private organization not affiliated with the securities' industry.<sup>7</sup> With the recent explosion of investor grievances, and hence, arbitrations,<sup>8</sup> the brokerage houses are feeling the financial bite of subsidizing this burgeoning area of alternative dispute resolution.<sup>9</sup> While the number of

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1. 490 U.S. 477 (1989).

2. 482 U.S. 220 (1987).

3. In *McMahon*, the Court held that broker-investor disputes involving claims arising under the 1934 Securities Exchange Act were arbitrable. *Id.* at 238. The Court in *Rodriguez* went one step further and held that disputes arising under the 1933 Securities were also arbitrable. *See Rodriguez*, 490 U.S. at 480-81.

4. *See infra* note 59 and accompanying text.

5. Serota, *The Unjustified Furor Over Securities Arbitration*, 16 PEPPERDINE L. REV. S105 (1989).

6. Lipton, *The Standard On Which Arbitrators Base Their Decisions: The SROs Must Decide*, 16 SEC. REG. L.J. 3, 3-4 (1988).

7. Robbins, *A Practitioner's Guide to Securities Arbitration*, 650 PLI/CORP 15, 144 (1989).

8. Katsoris, *The Level Playing Field*, 37 FORDHAM URB. L.J. 419, 421 (1990).

9. *See Street Eager for Arbitration Superforum*, Wall St. J., Aug. 24, 1990, § C at 1, col. 3 (eastern ed.).

arbitrations before industry forums declined by 11.4% in 1989 from a 1988 high of over 6000, the 10 years beginning in 1980 and ending in 1989 have seen a steady increase in customer-broker arbitrations.<sup>10</sup>

Pressures by customers as well as brokerage houses are continually shaping the contours of securities arbitration,<sup>11</sup> with some help from the courts<sup>12</sup> and the Securities Exchange Commission (SEC).<sup>13</sup> Some securities arbitration commentators are calling for the creation of a new arbitral forum.<sup>14</sup> Ideally, the new forum would alleviate customers' concerns regarding the perceived bias of the industry forums,<sup>15</sup> while substantially unburdening the brokerage houses of the expense of maintaining and funding the forums.<sup>16</sup>

This Comment will discuss the present forums available for customer-broker arbitration disputes, the problems arising in the current system, what changes in the present system may help resolve these problems, and the desirability of creating a new forum to handle all securities arbitrations between customers and brokers. This Comment will not challenge the desirability of arbitrating customer-broker disputes in general.<sup>17</sup> Indeed, many scholars and commentators argue that arbitration is beneficial to both the customer and the broker because it provides a more efficient and less expensive means of settling disputes than litigation.<sup>18</sup> However, for arbitration to effectively handle customer grievances, it is not merely enough that the process be fair, but the customer must *perceive* it to be fair.<sup>19</sup> But first, a brief overview of the legal history of securities arbitration would be helpful.

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10. *Wall Street Prods Investors to Mediate Rather Than Arbitrate Broker Disputes*, Wall St. J., Dec. 20, 1990, § C at 1, col. 3 (eastern ed.).

11. See generally Katsoris, *supra* note 8. In his article, Professor Katsoris traces the history of securities arbitration from its beginnings to the Supreme Court's most recent decision in *Rodriguez*, taking into account the forces that created the present system. He concludes by stating his views on the direction securities arbitration should move in the future to insure that the process continues as a fair and efficient way to settle broker-investor disputes.

12. The courts have continued to play an important role in furthering the enforceability of pre-dispute arbitration agreements by allowing the agreement not only to limit the customer to arbitration as opposed to litigation, but by allowing the agreement to limit the customer to certain industry-backed arbitral forums. See *infra* notes 104-34 and accompanying text.

13. The SEC serves as a watchdog over arbitral forums established and controlled by the brokerage houses. See *infra* note 79 and accompanying text.

14. *Street Eager for Arbitration Superforum*, *supra* note 9.

15. See *infra* notes 210-29 and accompanying text.

16. *Id.*

17. For a criticism of arbitration of customer-broker disputes, see Comment, *Just Saying No: Avoiding Predispute Agreements to Arbitrate in Securities Cases*, 1990 J. DISP. RESOL. 117.

18. Katsoris, *supra* note 8, at 421; Lusardi, *Enforcement of Securities Agreements in Securities Fraud Disputes*, 41 RUTGERS L. REV. 541, 545 (1989).

19. Katsoris, *supra* note 8, at 421; Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN. L.R. 393, 460 (1987). See Lusardi, *supra* note 18, at 584-85.

## II. HISTORY

The Supreme Court first addressed the enforceability of pre-dispute agreements to arbitrate customer-broker disputes in 1953 in *Wilko v. Swan*.<sup>20</sup> The Court held that claims arising under the Securities Act of 1933 (1933 Act)<sup>21</sup> could not be subject to arbitration pursuant to a pre-dispute arbitration agreement.<sup>22</sup> Because the 1933 Act provided customers certain substantive rights enforceable in federal court, the Court reasoned that pre-dispute arbitration agreements could not strip customers of their statutory right to a remedy in court.<sup>23</sup> The Court noted the strong federal policy favoring enforceability of arbitration agreements embodied in the Federal Arbitration Act (FAA).<sup>24</sup> However, it decided the danger of brokers' maneuvering clients into situations potentially weakening their right to recover under the 1933 Act, as well as the unpredictability of arbitration results, mandated the use of litigation.<sup>25</sup> In a nutshell, the Court viewed arbitration as an inadequate means to enforce customers' rights expressly granted under the 1933 Act.<sup>26</sup>

Whether or not claims brought under the Securities Exchange Act of 1934 (1934 Act)<sup>27</sup> were arbitral pursuant to pre-dispute arbitration agreements was left unanswered by the Court until it addressed the issue 34 years later in *Shearson/American Express v. McMahon*.<sup>28</sup> In *McMahon*, the Court chose the FAA as its analytical starting point.<sup>29</sup> It noted that the FAA's purpose was to reverse judicial hostility toward arbitration by placing arbitration agreements on equal footing with other contracts.<sup>30</sup> The Court read *Wilko* to bar arbitration agreements only when arbitration was incapable of protecting the substantive rights provided under federal law.<sup>31</sup> The Court reasoned that current arbitration proceedings conducted at forums controlled by the securities exchanges and under the auspices of the Securities Exchange Commission adequately protected the statutory rights granted to customers under the 1934 Act.<sup>32</sup> Furthermore, the

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20. 346 U.S. 427 (1953).

21. 15 U.S.C. §§ 77(a)-77(aa) (1982). The 1933 Act is intended to have "two basic objectives: [t]o require that investors be provided with material information concerning securities offered for public sale; and [t]o prevent misrepresentation, deceit, and other fraud in the sale of securities." L. SODERQUIST, *SECURITIES REGULATION* 2-3 (2d ed. 1988).

22. *Wilko*, 346 U.S. at 438.

23. *Id.* at 435, 438.

24. 9 U.S.C. §§ 1-14 (1982).

25. *Wilko*, 346 U.S. at 432.

26. *Id.* at 435-37.

27. 15 U.S.C. §§ 78(a)-78(kk) 1982. The 1934 Act "seeks to ensure fair and orderly securities markets by prohibiting certain types of activities and by setting forth rules regarding the operation of the markets and participants." L. SODERQUIST, *supra* note 21, at 4.

28. 482 U.S. 220 (1987).

29. *Id.* at 225.

30. *Id.*

31. *Id.* at 228-29.

32. *Id.* at 233.

Court alluded to a greatly expanded role for arbitration in customer-broker disputes when it strongly implied that treble damages under RICO were not to be outside the scope of the arbitrator's power to award damages.<sup>33</sup>

Just two years later in *Rodriguez*,<sup>34</sup> the Supreme Court overturned its decision in *Wilko* and held that pre-dispute arbitration agreements could be enforceable for 1933 Act claims.<sup>35</sup> The Court went on to reject *Wilko* because its reasoning was antiquated and out of touch with the modern realities of arbitration.<sup>36</sup> Hence, the Court ruled that pre-dispute arbitration clauses were enforceable regardless of the underlying civil claim.<sup>37</sup>

The effect of the Supreme Court's rulings in *McMahon* and *Rodriguez* has been the increasing prevalence of arbitration as the sole mechanism of dispute resolution in customer-broker disputes.<sup>38</sup> However, the issue of what is the proper arbitral forum is far from settled.<sup>39</sup>

### III. AVAILABLE FORUMS FOR CUSTOMER-BROKER SECURITIES CLAIMS

At present, there are two basic forum alternatives for securities arbitration.<sup>40</sup> One alternative is arbitrating before forums controlled and subsidized by the securities industry, where the vast majority of customer-broker claims are heard.<sup>41</sup> The other is arbitration before the American Arbitration Association (AAA).<sup>42</sup>

#### A. SRO Forums

Various stock exchanges and the North Association of Securities Dealers (NASD)<sup>43</sup> serve as Self Regulatory Organizations (SROs) for member brokerage houses, establishing rules for arbitration procedures.<sup>44</sup> For example, large brokerage houses such as Merrill Lynch or Shearson/American Express are members of the securities exchanges they trade on, such as the New York Stock

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33. *Id.* at 238.

34. 490 U.S. 477 (1989).

35. *Id.* at 485.

36. *Id.*

37. *Id.*

38. See Katsoris, *supra* note 8, at 421.

39. See *infra* notes 104-58 and accompanying text.

40. Katsoris, *supra* note 8, at 469-70.

41. *Securities Firms Oppose SEC Bid to Give Investors More Flexibility on Arbitration*, Wall St. J., June 22, 1990, § C at 16, col. 5 (eastern ed.).

42. Katsoris, *supra* note 8, at 469-70.

43. Armbrust, *Litigation Limited Partners' Securities Actions: Regulatory Framework*, 391 PLI/CORP 21, 93 (1991).

44. Katsoris, *supra* note 8, at 427-29.

Exchange (NYSE), as well as being members of the NASD.<sup>45</sup> SROs such as the NASD and NYSE, which are funded by the member brokerage houses, subsidize arbitrations conducted in an SRO forum.<sup>46</sup>

In 1977, a movement toward uniformity in SRO arbitrations began with an effort to develop an effective means of handling small claims by customers against brokerage houses.<sup>47</sup> The result of this effort was the formation of the Securities Industry Conference on Arbitration (SICA).<sup>48</sup> SICA members included SROs, the Securities Industry Association (SIA)<sup>49</sup> and the general public.<sup>50</sup>

The SICA initially established a small claims procedure and later developed a Uniform Code of Arbitration (Code) which was to govern all customer claims brought in SRO forums.<sup>51</sup> In 1979, SROs participating in the SICA adopted the Code, which has been revised since *McMahon*.<sup>52</sup> The SICA meets and amends its rules periodically, but before the new rules go into effect they must be adopted by the SROs individually and approved by the Securities and Exchange Commission (SEC).<sup>53</sup> Usually, but not always, the SROs adopt the SICA rules.<sup>54</sup> The SEC is involved in this process in an oversight capacity, making suggestions to the SICA and revising SICA rules and amendments.<sup>55</sup> The SICA continues to meet and modify the Code.<sup>56</sup>

In 1989, approximately 5,500 arbitration claims were brought before SRO arbitration forums with over 65% of those heard by the NASD.<sup>57</sup> The NYSE accounts for another 27% of the SRO arbitrations.<sup>58</sup>

### B. AAA Arbitration

The American Arbitration Association (AAA) provides an alternative to SRO forums for securities arbitration.<sup>59</sup> The AAA is a non-profit organization founded in 1926 to encourage all types of alternative dispute resolution.<sup>60</sup> The

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45. See generally Robbins, *supra* note 7.

46. *Id.*

47. Katsoris, *Securities Arbitration After McMahon*, 16 FORDHAM URB. L.J. 361, 362-63 (1988).

48. *Id.*

49. "The SIA is a trade association for the securities industry." *Id.* at 362 n.9.

50. Katsoris, *supra* note 47, at 362. Public representatives include attorneys, law professors and others with expertise in the field. *Id.* at 362 n.10.

51. *Id.* at 369.

52. Robbins, *supra* note 7, at 24.

53. *Id.*

54. Katsoris, *supra* note 8, at 451-52.

55. *Id.* at 429-30.

56. *Id.* at 430.

57. See *Street Eager for Arbitration Superforum*, *supra* note 9.

58. *Id.*

59. Katsoris, *supra* note 8, at 469-72.

60. Robbins, *supra* note 7, at 15, 24.

AAA has no affiliation with the securities industry.<sup>61</sup> AAA arbitrations are conducted pursuant to the AAA's Securities Arbitration Rules (SARs) which were adopted by the AAA in 1987 and amended in 1989.<sup>62</sup>

#### IV. AAA v. SRO ARBITRATION

There are noticeable differences between AAA arbitration and SRO arbitration.<sup>63</sup> Moreover, there is a common perception that SRO forums are more favorable to brokers, and that AAA forums are more hospitable to investors.<sup>64</sup>

##### A. Cost and Efficiency

As of 1988, SRO forums generally processed disputes more quickly<sup>65</sup> and inexpensively for customers than AAA forums.<sup>66</sup> SRO forums are heavily subsidized by the securities industry, allowing them to offer services to customers for much less than the AAA, even though the SROs have recently increased the costs of their services.<sup>67</sup> Filing fees for claims of \$1,000 and less are now \$30,<sup>68</sup> ranging up to \$1800 for claims of \$5 million or more.<sup>69</sup> Also, in cases requiring more than one four hour session, arbitrators have discretion to assess the costs to either party.<sup>70</sup> The policy of the SROs' new rules, according to James E. Buck, senior vice-president at the NYSE, is to require "[a] customer who brings an arbitration for \$1 million . . . [to] carry his own freight."<sup>71</sup> On the other hand, the AAA charges 3% on any claim up to \$25,000 with a minimum charge of \$300, and a smaller percentage administrative fee applied to amounts in excess of \$25,000.<sup>72</sup> Because the SRO hearing fees can make extended arbitrations more costly, the AAA has challenged the notion that SRO arbitration is always less expensive for larger claims.<sup>73</sup>

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61. *Id.* at 19.

62. *Id.* at 25.

63. *Id.* at 144.

64. Robbins, *Securities Arbitration: Preparation and Presentation*, 42 ARB. J. 3, 4 (vol. 2, 1987).

65. Robbins, *supra* note 7, at 9.

66. See *Street Eager for Arbitration Superforum*, *supra* note 9.

67. *Investors' Fees for Arbitration to Go Higher*, Wall St. J. Aug. 28, 1990, § C at 1, col. 3 (eastern ed.).

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. Securities Arbitration Rules [S.A.R.s] *Administrative Fee Schedule*.

73. Comparisons of AAA and SRO Arbitration Systems, Securities Arbitration Practice Seminar, Nov. 7, 1990 (NYCLACLE). "The SROs charge on a per hearing basis. Thus, a \$100,000 case taking three hearings will have a fee of \$2,250 (\$750) x 3 hearings). The AAA fee is \$1,500. Also, about 2.3% of AAA cases involve more than \$50,000, so the low SRO fee for

### B. Speed

In 1988, the average time to process a dispute, from receiving a claim to releasing the award, was 8.2 months at the NYSE, 12.1 months at the NASD and 16.8 months at the AAA.<sup>74</sup> However, recent data provided by the AAA states the median time to process an arbitration claim is only 9.3 months.<sup>75</sup>

One reason why AAA arbitration may take longer than its SRO counterpart is that AAA procedural rules do not require an answer by the respondent, as do SRO forums, which leaves the customer/claimant wondering what to expect at the first hearing.<sup>76</sup> Furthermore, AAA requires less specificity in its complaint than do SRO forums, and "unfortunately, less . . . is usually presented."<sup>77</sup>

Another difference worth noting is that the SICA, which promulgates rules for later adoption by individual SROs, is subject to SEC oversight; the AAA is not.<sup>78</sup>

### C. Impartiality

Seemingly, the main appeal to customers of the AAA forum is the perception that it is impartial, not pro-brokerage house, as the SRO forums are perceived to be.<sup>79</sup> However, the SICA Code, generally adopted by most brokerage houses, requires that all cases involving disputes of more than \$10,000<sup>80</sup> shall be heard by three arbitrators.<sup>81</sup> The majority of the arbitrators serving on the three person panels may not be affiliated with the securities industry.<sup>82</sup> Disputes involving less than \$10,000 are heard by one arbitrator who is not affiliated with the industry.<sup>83</sup> Until 1987, none of the AAA's security's arbitrators could be affiliated with the securities industry.<sup>84</sup> However, AAA rules now provide that in cases involving more than \$25,000, one of the arbitrators on the three person

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very small claims may be of little value. Also, the AAA will waive, reduce or defer the fee in verifiable hardship situations (SAR § 48). Finally, a party may recover the fee as part of the arbitration award." *Id.*

74. Robbins, *supra* note 7, at 148.

75. Friedman, *AAA Securities Arbitration: What You Need to Know Securities Arbitration Practice Seminar*, Nov. 7, 1990, 2 (NYCLACLE).

76. Robbins, *supra* note 7, at 148.

77. *Id.* at 23.

78. *Id.* at 3, 5.

79. *See supra* note 7 and accompanying text.

80. Uniform Code of Arbitration [UCA] § 8.

81. *Id.*

82. Specifically excluded from serving as public arbitrators are brokers and registered investment advisors, retired industry personnel, people who worked in the industry within the last three years, professionals who spend over 20% of their time serving security industry clients and spouses of industry personnel. *Id.*

83. *Id.* at § 2.

84. Robbins, *supra* note 7, at 20.



panel must have an industry affiliation.<sup>85</sup> Providing a sizable corps of capable securities arbitrators without industry ties could be difficult for the AAA. In 1989, of the AAA's 50,000 arbitrators, approximately 1,400 were qualified to hear securities arbitration, and 57% of those—or 804 arbitrators—were affiliated with the securities industry.<sup>86</sup>

#### D. Choosing the Arbitrator

SRO and AAA forums employ different means of choosing the arbitrator. Under the SICA Code, which generally governs SRO arbitrations,<sup>87</sup> the SRO's Director of Arbitration chooses the arbitrator or panel.<sup>88</sup> The Director must inform the parties of the arbitrators' names and employment history for the last ten years, as well as any conflicts of interest the arbitrators may have.<sup>89</sup> The arbitrators themselves are required to disclose to the Director "any circumstances that might preclude such arbitrator from rendering an impartial and objective determination."<sup>90</sup> The parties may make one peremptory challenge and an unlimited number of challenges for cause.<sup>91</sup>

At the AAA, the parties themselves choose the arbitrator. Like the SROs, the AAA requires at least one industry affiliated arbitrator on three person panels for larger disputes. Each party is given two lists: one containing names of industry arbitrators, and the other listing non-industry arbitrators.<sup>92</sup> The parties strike the names of arbitrators they do not want to hear their case and number the remaining names on each list according to preference.<sup>93</sup> The AAA then merges the lists of the two parties and invites arbitrators whom neither party eliminated "in accordance with the designated order of mutual preference."<sup>94</sup> If the parties are unable to agree on arbitrators, the AAA will choose the panel.<sup>95</sup> The parties have access to extensive biographical data about the arbitrators, including their history as arbitrators.<sup>96</sup>

Some experienced arbitrators and commentators maintain that the securities industry arbitrators on SRO panels are quick to spot broker wrongdoing and are generally motivated by an honest desire to keep the industry free of unscrupulous

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85. S.A.R.s §§ 9, 13.

86. Robbins, *supra* note 7, at 21. As of November 1990, 53.7% or 1,362 of the AAA's pool of securities arbitrators are affiliated with the securities industry. Friedman, *supra* note 75, at 7.

87. See *supra* notes 51-56 and accompanying text.

88. UCA § 8.

89. *Id.* at § 9.

90. *Id.* at § 11.

91. *Id.* at § 10.

92. *Id.* at § 13.

93. *Id.*

94. *Id.*

95. *Id.* at § 14.

96. See Friedman, *supra* note 75, at 3.

practices.<sup>97</sup> However, the system suffers from a fatal flaw in many customers' eyes: customers are not only being denied access to the courts pursuant to a colorable adhesive contract, but they must also bring their claim before an arbitral forum established and subsidized by the alleged wrongdoer.<sup>98</sup> It is not so unreasonable that customers may perceive themselves as facing a "stacked deck."<sup>99</sup>

## V. YOUR FORUM OR MINE?

Brokerage firms control the selection of arbitral forums in pre-dispute clauses and usually prefer to limit customers to SRO forums.<sup>100</sup> Customers have challenged arbitration agreements that limit the available arbitral forums to SRO forums and preclude arbitration before the AAA.<sup>101</sup> Customers usually base their challenge on a provision which is arguably one of the securities exchanges' rules, the American Stock Exchange (AMEX) constitution, which allows arbitration before the AAA under certain circumstances.<sup>102</sup> It should be noted that member brokerage houses are subject to the rules of the exchanges on which they trade—including the AMEX constitution.<sup>103</sup>

### A. The AMEX Window

Shortly after the Supreme Court decided in *McMahon* that customers' claims under the 1934 Act were arbitral,<sup>104</sup> the parties in that case found themselves in federal district court litigating whether the McMahons' claim should be arbitrated before the AAA or the New York Stock Exchange.<sup>105</sup> The arbitration agreement between the McMahons and Shearson contained a provision that the McMahons believed incorporated a portion of the AMEX constitution known as

97. See Serota, *supra* note 5, at S108-09.

98. *Securities Firms Oppose SEC Bid to Give Investors More Flexibility on Arbitration*, *supra* note 41, at col. 5. David Robbins, formerly director of arbitration at the AMEX and now an attorney with a New York law firm, stated, "It's bad enough that access to court is foreclosed, let alone a forum with no allegiance to the securities industry." *Id.*

99. *McMahon*, 482 U.S. at 260-61 (J. Blackmun, dissenting). See also Katsoris, *supra* note 47, at 383-84.

100. "As a matter of industry practice, arbitration clauses are included in customer account agreements between brokerage firms and their customers." Bedell & Bosch, *The Rodriguez Decision: A New Tradition in the Arbitration of Securities Disputes*, 18 SEC. REG. L.J. 53, 53 (1990). See generally *SEC Urges Firms to Widen Options to Include Independent Panels*, Wall St. J., June 11, 1990, § C at 5, col. 4 (eastern ed.). While it appears most large brokerage house limit their customers to SRO arbitration in pre-dispute agreements, a notable exception is A.G. Edwards & Sons Inc., who claims it does not notice a significant difference among arbitral panels.

101. See *infra* notes 104-58 and accompanying text.

102. *Id.*

103. Robbins, *supra* note 7, at 140-41.

104. See *supra* note 3.

105. *McMahon*, 709 F. Supp. at 370.

the "AMEX Window".<sup>106</sup> In a nutshell, the AMEX window allows customers to request arbitration before the AAA if they have not expressly agreed to another forum.<sup>107</sup>

It is well-settled that the arbitration agreement can limit the arbitral forums available to customers.<sup>108</sup> Frequently, arbitration agreements provide that disputes between the broker and the customer shall be arbitrated according to the "rules" of the AMEX, as well as other SRO forums, such as the NYSE and the NASD.<sup>109</sup> This is where the AMEX window comes into play. The AMEX constitution provides that customers be allowed "to elect to arbitrate before the [AAA] in the city of New York, unless the customer has expressly agreed in writing to submit only to the arbitration procedure of the Exchange."<sup>110</sup> The issue before the courts now is whether this section allows customers who have agreed to arbitrate according to the "rules" of various SROs, including the AMEX, to choose to arbitrate before the AAA.<sup>111</sup> The customers' argument is that the AMEX constitution is an SRO "rule" and becomes part of the arbitration agreement. Therefore, absent customer agreement to limit himself to arbitration "only before" certain SRO forums, the customer is free to step through the "AMEX window" into an AAA forum.<sup>112</sup> However, various federal district court decisions have rejected this proposition,<sup>113</sup> primarily on the basis that the

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106. *Id.* at 372 n.7.

107. *Id.* at 371. The investment contract included a provision that stated the arbitration would be "in accordance with the rules then in effect, of the [NASD, or the NYSE] and/or the American Stock Exchange, Inc. as I (customer) may elect." The McMahons argued that the "rules" referred to in the agreement included the AMEX constitution which provides that "... the customer may elect to arbitrate before the [AAA] in the city of New York unless the customer has expressly agreed in writing to submit only to the arbitration procedure of the Exchange." (emphasis added). (AMEX CONST. art. VIII, § 2(c)). However, the court did not decide whether or not the language in the arbitration agreement allowed the customer to elect to arbitrate before the AAA, but held that the McMahons had waived their right to choose a forum by failing to comply with another provision of the agreement requiring the customer to choose the forum within a certain time period. *McMahon*, 709 F. Supp. at 373.

108. See *Merrill Lynch, Pierce, Fenner, & Smith, Inc. v. Georgiadis*, 903 F.2d 109 (2d Cir. 1990). However, as the court noted, the SEC "prohibits arbitration agreements which limit customers to a single SRO arbitration forum." (SEC Litigation Release No. 12198, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶84, 437 (August 7, 1989)) *Georgiadis*, 903 F.2d at 113. Thus, arbitration agreements which limit the customer to more than one SRO forum are not invalid.

109. See, e.g., *Cowen & Co. v. Anderson*, 76 N.Y.2d 318, 559 N.Y.S.2d 225 (N.Y. 1990); *PaineWebber, Inc. v. Pitchford*, 721 F. Supp. 542 (S.D.N.Y. 1989); *PaineWebber, Inc. v. Rutherford*, 903 F.2d 106 (2d Cir. 1990); *McMahon*, 709 F. Supp. 369; *Wilson v. D.H. Blair & Co.*, 731 F. Supp. 1359 (N.D. Ind. 1990); *Bear Stearns & Co. v. N.H. Karol & Assocs.*, 728 F. Supp. 499 (N.D. Ill. 1989); *Hybert v. Shearson Lehman/American Exp., Inc.*, 1989 W.L. 64450 (N.D. Ill.).

110. AMEX CONST. art. VIII § 2(c).

111. See *supra* note 109.

112. *Cowen*, 76 N.Y.2d at 322, 559 N.Y.S.2d at 227.

113. *Hybert*, 1989 W.L. 64450; *Karol & Assocs.*, 728 F. Supp. at 500, 503-04; *Pitch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 714 F. Supp. 537, 538 (D.D.C. 1989); *Pitchford*, 721 F. Supp. at 549.

AMEX constitution is not a "rule" referred to in the standard arbitration agreement.<sup>114</sup> Similarly, courts have reasoned that the parties never intended an agreement allowing arbitration according to the procedures of the NYSE, NASD and AMEX to create a fourth electable forum—the AAA.<sup>115</sup>

Supporting the customers' position is the New York Court of Appeals' decision in *Cowen & Co. v. Anderson*,<sup>116</sup> where the court noted that the AMEX constitution defines the "rules of the Exchange" to include the constitution itself.<sup>117</sup> The court concluded that because the "term 'rules' is not defined by the agreements . . . [the customer] is, therefore, entitled to rely on the provision in the AMEX constitution."<sup>118</sup> Furthermore, the court explained that even if the language of the agreement was ambiguous as to whether or not it allowed for arbitration before the AAA, the court would use normal contract principles and construe ambiguous terms against the drafter: the brokerage house.<sup>119</sup> It is important to note that the court bases its decision on the specific wording of the agreement. The court acknowledged that with proper drafting the brokerage houses had the right to shut the AMEX window and preclude customers from demanding arbitration before the AAA.<sup>120</sup>

On the other hand, the Second Circuit has held the language "in accordance with the rules then in effect of . . . the [AMEX]" does not open the "AMEX window".<sup>121</sup> However, that circuit has found similar language to be ambiguous as to whether the customer is strictly limited to the SRO forums, or is able to choose the AAA.<sup>122</sup> In *Formica v. Malone*,<sup>123</sup> the Second Circuit held that a clause in an arbitration agreement allowing for "arbitration . . . on the [NYSE], or before an arbitration facility provided by the [AMEX]" was ambiguous as to whether the clause invoked the AMEX window; therefore, the customer was allowed to choose to arbitrate before the AAA.<sup>124</sup> The court discussed both its

114. *Id.* Cf. *Cowen*, 76 N.Y.2d at 323, 559 N.Y.S.2d at 227.

115. *Pitchford*, 721 F. Supp. at 550.

116. 559 N.Y.S.2d 225 (Ct. App. 1990), *appeal dismissed without opinion*, 76 N.Y.S.2d 935, 563 N.Y.S.2d 65, 564 N.E.2d 675 (1990).

117. *Id.* at 226 (AMEX CONST. art. I, § 3(a)).

118. *Id.* at 226-27.

119. *Id.* at 228.

120. *Id.* at 227. The court harmonized its decision in *Cowen* with the Second Circuit's decision earlier that same year in *Georgiadis*, 903 F.2d 109, reasoning that the language "[a]ny controversy between us . . . shall be settled by arbitration *only before* the National Association of Securities Dealers, Incorporated, or the New York Stock Exchange, or an Exchange located in the United States on which listed options transactions are executed' . . . bound . . . [the customers] . . . to arbitrate their claim 'only before' the three self-regulatory organizations." *Cowen*, 76 N.Y.2d at 322, 559 N.Y.S.2d at 227.

121. *Rutherford*, 903 F.2d 106, 108.

122. See *Formica v. Malone*, 907 F.2d 397, 400 (2d Cir 1990).

123. *Id.*

124. *Id.* at 398-400.

own earlier decision in *Merrill Lynch v. Georgiadis*<sup>125</sup> and the New York Court of Appeals decision in *Cowen*, and concluded that the interpretation of the specific language used in the agreement was not controlled by either decision.<sup>126</sup> The Second Circuit remanded the case to the district court to determine the parties' intent expressed in the agreement.<sup>127</sup>

One broker's attorney has opined that after *Cowen*, the outcome of the legal challenge to the choice of arbitration forums will depend on whether the case is brought in New York state or federal court.<sup>128</sup> While the *Cowen* Court attempted to harmonize its decision with the Second Circuit's decision in *PaineWebber, Inc. v. Rutherford*,<sup>129</sup> a close reading of the two cases suggests that New York state law and federal law conflict in this area.<sup>130</sup> Regardless of the state and federal law conflict, New York law has a pervasive effect outside of New York, because most customer agreements around the nation have choice of law provisions stating the contract is subject to the law of the state of New York.<sup>131</sup> Earlier this year, the Connecticut Supreme Court was confronted with a case in which the customer had entered a securities contract with PaineWebber providing for "arbitration in accordance with the rules then in effect of . . . the American Stock Exchange . . .".<sup>132</sup> The parties agreed the Contract was to be governed by New York state law.<sup>133</sup> The court, relying on *Cowen*, held that the AMEX window was open to the customer.<sup>134</sup>

The AMEX window may soon become a matter of purely academic interest. The AMEX has moved to amend its constitution to end the confusion and conclusively close the window in those situations where the customer agrees to arbitrate pursuant the "rules" of the AMEX and other SRO forums.<sup>135</sup> However, the SEC has yet to approve the proposed amendment, and at least one commentator feels that the New York court's opinion in *Cowen* "gives opponents of the change significant support."<sup>136</sup> Perhaps a greater threat to the window's

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125. In *Georgiadis*, the customer signed an arbitration agreement stating "[A]ny controversy between us arising out of such option transaction or this agreement shall be settled by arbitration only before the [NASD or the NYSE] or an Exchange located in the United States upon which listed options transactions are executed." *Georgiadis*, 903 F.2d at 111 (emphasis in original). The court held the customer was bound to arbitrate its dispute "only before" one of the enumerated forums, and could not demand arbitration before the AAA. *Id.* at 113.

126. *Formica*, 907 F.2d at 399-400.

127. *Id.*

128. Spencer, *AMEX Window Opened for Aggrieved Investors*, 7/11/90 N.Y.L.J. (col. 5) at 3.

129. 903 F.2d 106.

130. See *Cowen*, 76 N.Y.2d at 320-21, 559 N.Y.S.2d at 226-27; *Rutherford*, 903 F.2d at 107-08.

131. Spencer, *Court of Appeals to Rule in Suit on Arbitration: Broker-Customer Disputes Head 23 Appeals on Docket 5/29/1990* N.Y.L.J., 1 (col. 5) at 5-6.

132. *PaineWebber, Inc. v. American Arbitration Association*, 1991 WL 4492 (Conn.) p. 3.

133. *Id.*

134. *Id.* at 3-4.

135. See Katsoris, *supra* note 8, at 471-72.

136. Spencer, *supra* note 131, at 4.

use is that even the New York state court in *Cowen* conceded that the brokerage houses may shut the window with proper drafting of pre-dispute arbitration agreements.<sup>137</sup>

### *B. Customers Without Arbitration Agreements*

Customers who have not signed pre-dispute arbitration agreements may also avail themselves of the AMEX constitution and demand that brokerage houses trading on the AMEX arbitrate disputes before the AAA.<sup>138</sup> While the vast majority of customers enter pre-dispute arbitration agreements,<sup>139</sup> it appears that it is generally the larger investors that escape the agreements.<sup>140</sup>

As noted earlier, pursuant to article VIII section 2(c) of the AMEX constitution customers may demand arbitration before the AAA "unless the customer has expressly agreed to submit only to the arbitration procedure of the Exchange."<sup>141</sup> Obviously, customers who have not entered a pre-dispute arbitration agreement could not have "expressly agreed to submit" only to an SRO forum, thereby waiving their rights to demand arbitration before the AAA. However, a question arises as to whether customers are free to bring their claim before any AAA forum, or if they are limited only to demanding arbitration before the AAA in New York City,<sup>142</sup> which is the hub of securities activities.

In *PaineWebber Inc. v. Pitchford*,<sup>143</sup> a New York federal district court held that customers who had not signed a pre-dispute arbitration agreement were allowed to bring their claims before the AAA, but the brokerage house was able to limit the forum to the AAA in New York City.<sup>144</sup> The customers wanted to bring their claim before the AAA in Florida.<sup>145</sup> The court based its decision on its interpretation of the relevant portion of the AMEX constitution.<sup>146</sup> The brokerage house, PaineWebber, conceded that, as a member of the AMEX it was obligated to accept arbitration before the AAA in New York City if the customer so requested and had not agreed to limit himself strictly to SRO forums.<sup>147</sup> The court held that as applied to customers who had not entered a pre-dispute arbitration agreement, the phrase "in the City of New York" was a venue-selecting

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137. See *supra* note 120 and accompanying text.

138. See, e.g., *Pitchford*, 721 F. Supp. at 551.

139. Comment, *supra* note 17, at 131.

140. See *Pitchford*, 721 F.Supp. 542; *Rutherford*, 903 F.2d 106; *Boudreau v. L.F. Rothschild Co.*, 1990 W.L. 81861 (M.D. Fla.).

141. AMEX CONST. art. VIII, § 2(c).

142. See *Pitchford*, 721 F. Supp. 542; *Rutherford*, 903 F.2d 106; *Boudreau*, 1990 W.L. 81861.

143. 721 F. Supp. at 542.

144. *Id.* at 552.

145. *Id.* at 543.

146. *Id.* at 551.

147. *Id.* See also *supra* note 98 and accompanying text.

clause that obligated the brokerage house to arbitrate before the New York AAA only, not any AAA forum the customer may choose.<sup>148</sup>

While the court's decision in *Pitchford* rests on its interpretation of the "plain language" of the AMEX constitution,<sup>149</sup> a district court in Florida decided the matter differently in *Boudreau v. L.F. Rothschild Co., Inc.*<sup>150</sup> In *Boudreau*, a customer who had not signed an arbitration agreement filed for arbitration before the AAA in Orlando, Florida, in reliance on article VIII section 1 of the AMEX constitution.<sup>151</sup> The Orlando AAA agreed to hear the claim, but the brokerage house challenged the AAA's propriety as the arbitral forum.<sup>152</sup> The *Boudreau* court reasoned that the customer validly demanded arbitration pursuant to the mandate of the AMEX constitution and properly exercised that right when he chose the AAA as the arbitral forum.<sup>153</sup> The court merely mentioned the federal district court's decision in *Pitchford* and went on to conclude that the determination as to where the arbitration is to take place was one for the arbitrator.<sup>154</sup> It would seem highly probable that the AAA arbitrator in Orlando would find the Orlando AAA was a proper forum after initially agreeing to hear the matter.

In *Pitchford*, the federal district court held the customer was limited to arbitration before the AAA in New York City.<sup>155</sup> But more interesting than the court's holding or legal reasoning was the fact that PaineWebber, the brokerage house, was seemingly only willing to arbitrate with the customer because of the legal compulsion of the AMEX constitution.<sup>156</sup> If the customer, unfettered by a pre-dispute arbitration clause, wanted to arbitrate before a different AAA forum, it would have to be by a voluntary post-dispute agreement with PaineWebber.<sup>157</sup> Absent an agreement to arbitrate, the customers would have to bring their claims the old-fashioned way—in federal court.<sup>158</sup>

Whether PaineWebber would agree to arbitrate in an AAA forum outside of New York City, in lieu of litigation, remains to be seen. However, the large New

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148. *Pitchford*, 721 F. Supp. at 551.

149. *Id.*

150. 1990 W.L. 81861 (M.D. Fla.).

151. *Id.* at 3.

152. *Id.*

153. *Id.* at 4.

154. *Id.* at 3.

155. See *supra* note 137 and accompanying text.

156. *Pitchford*, 721 F. Supp. at 550-51. See also *supra* note 98 and accompanying text.

157. See *Scher v. Bear Stearns, Inc.*, 723 F. Supp. 211, 213. See also Hollering, *Enforcement of Agreement*, 9/13/90 NYLJ 3 (col. 1) "ARBITRATION IS A CONSENSUAL process in which contracting parties, either at the time of a dispute or by means of a future disputes clause, agree to resolve their disputes in an arbitral rather than a judicial forum. Both federal and state arbitration law, and a wealth of judicial authority, provide for the prompt and vigorous enforcement of arbitration agreements, like other contracts, pursuant to their terms." *Id.* (emphasis added).

158. *Id.*

York brokerage houses have shown an aversion to non-SRO arbitration outside the friendly confines of New York City,<sup>159</sup> possibly for good reason.<sup>160</sup>

## VI. GIVING THE CUSTOMER A CHOICE

As the customer's choice of arbitral forums is increasingly being narrowed to SRO forums exclusively,<sup>161</sup> it appears now is the time for Congress and/or the SEC to take affirmative steps to insure fairness in the arbitral process.<sup>162</sup> Because federal courts have continually struck down state regulatory efforts due to federal preemption in the arbitration field,<sup>163</sup> the burden to make changes falls squarely upon the SEC and Congress.<sup>164</sup> One of these two entities should, at minimum, mandate that customers bound by arbitration agreements have a right to bring their claims before non-SRO forums—namely the AAA.

In response to the Supreme Court's holding in *McMahon*,<sup>165</sup> the Securities Arbitration Reform Act of 1988 (hereinafter Reform Act)<sup>166</sup> was introduced into Congress. The Reform Act would have required that arbitration agreements be placed on a separate page of customer-broker account contracts, be separately signed by the customer, and include a disclosure provision explaining to the customer the consequences of entering the agreement.<sup>167</sup> Moreover, the bill would also have prohibited brokerage houses from making a pre-dispute arbitration

159. Robbins, *supra* note 7, at 9.

160. See *Securities Firms Charge Arbitration Bias*, Wall St. J., Aug. 31, 1990, § C at 1. PaineWebber and Neuberger & Berman brought a lawsuit challenging an arbitration decision by the Philadelphia Stock Exchange awarding aggrieved options traders more than \$1 million in damages, accusing the Exchange of "choos[ing] sides and favoring the hometown boys." *Id.*

161. See *supra* notes 108-15.

162. Katsoris, *supra* note 8, at 477; Serota, *supra* note 5, at S112-13; Brown, Shell, & Tyson, *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3, 33-36 (1987); Lusardi, *supra* note 18, at 541, 590.

163. On October 29, 1990, the United States District Court for the Southern District of Florida struck down an amendment to FLA. STAT. § 517.122 (1988) requiring brokerage houses to allow customers to choose to arbitrate disputes before the AAA or another non-industry forum as well as an industry forum. *Security Indus. Assoc. v. Lewis*, 751 F. Supp. 205 (1990). The court found the Florida statute was preempted by federal law, namely the FAA. *Id.* at 206. The district court's decision cited a recent First Circuit decision, *Securities Indus. Assoc. v. Connolly*, 883 F.2d 114 (1st Cir. 1989). *Lewis*, 751 F. Supp. at 206. In *Connolly*, the court struck down a Massachusetts statute which prohibited brokers from requiring non-institutional customers to enter mandatory pre-dispute arbitration agreements as a condition for doing business with the brokerage house. The *Connolly* court held the statute was preempted by the FAA. *Connolly*, 883 F.2d at 118, 122. See also Serota, *supra* note 5, at S111-12.

164. See Serota, *supra* note 5, at S112.

165. See *supra* notes 29-37 and accompanying text.

166. H.R. 4960, 100th Cong., 2d Sess. (1988). The sponsors of this bill were Rep. John Dingell (D-Mich.), Rep. Edward J. Markey (D-Mass.) and Rep. Frederick C. Boucher (D-Va.).

167. *Id.* at § 7(B)(i), (iii). UCA § 32 has adopted an approach very similar to that proposed by the authors and the NYSE has approved and adopted the disclosure requirements in its Arbitration Rules § 636.



agreement a condition for customers wishing to do business with the brokerage house.<sup>168</sup> The Reform Act provided that the SEC was to implement the changes by promulgating regulations, for which the Act set out minimum requirements.<sup>169</sup>

The House Subcommittee on Telecommunications and Finance, which oversees the SEC, held hearings on the Act on March 31, June 9, and July 12 of 1988.<sup>170</sup> The Securities Industry Association (SIA), Merrill Lynch & Co., Inc., Shearson, Lehman & Hutton, Inc., and the SICA represented the securities industry and testified before the subcommittee.<sup>171</sup> The Consumer Federation, the North American Securities Administrators Association, and the SEC, representing the public, were also present and testified.<sup>172</sup> At the hearings the SEC and the SICA convinced the subcommittee to allow them more time to work together to reform the arbitration process.<sup>173</sup> The SEC suggested numerous rule changes for the SICA to lobby the securities industry to adopt, including encouraging the brokerage houses to draft arbitration clauses offering the AAA as an alternative arbitral forum.<sup>174</sup> While the Arbitration Reform Act did not make it out of committee in 1988,<sup>175</sup> Representative Edward Markey, a co-sponsor of the bill, still believes the process needs to be reformed.<sup>176</sup> Markey was quoted recently in the Wall Street Journal as stating "there is still a question of whether or not individuals should be compelled to go to arbitration that is industry dominated. It's a freedom of choice question."<sup>177</sup>

Presently, the SEC is "prodding" the nation's largest stock exchanges to give customers the option of bringing their disputes to an independent arbitral forum.<sup>178</sup> The industry response has been a staunch refusal of the SEC's request.<sup>179</sup> Prior to the Supreme Court's holding in *McMahon*, the SEC had promulgated a regulation making it a "fraudulent, manipulative or deceptive act or practice" for a brokerage house to enter an agreement with a customer mandating arbitration of federal securities law claims.<sup>180</sup> While SEC no longer prohibits brokerage houses from requiring customers to agree to arbitrate federal

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168. *Id.* at § 7(B)(ii).

169. *Id.* at § 7(B).

170. Bedell & Bosch, *supra* note 100, at 84.

171. *Id.*

172. *Id.*

173. *Id.* at 85-86.

174. *Id.* at 85.

175. *Id.* at 84-87.

176. *Arbitration Cases Over Securities Declined Last Year*, Wall St. J., Dec. 3, 1990, § C at 5, col. 4 (eastern ed.).

177. *Id.*

178. *SEC Urges Firms to Widen Arbitration Options to Include Independent Panels*, *supra* note 100.

179. *Securities Firms Oppose SEC Bid to Give Investors More Flexibility on Arbitration*, *supra* note 41.

180. 17 C.F.R. 21240.15c2-2 (1987).

claims due to the Supreme Court's holdings in *McMahon* and *Rodriguez*,<sup>181</sup> a regulation mandating that customers be allowed to choose an independent arbitral forum would go a long way in allaying customers' fears of forum bias.

However, in response to SEC pressures to allow an AAA option in arbitration agreements, the SIA, a securities industry trade association, has claimed the lack of SEC oversight of AAA arbitration is problematic.<sup>182</sup> Apparently noting *McMahon's* reliance on SEC oversight of the arbitral process as grounds for upholding agreements requiring arbitration of 1934 Act claims,<sup>183</sup> the SIA argues that allowing customers to arbitrate disputes before an independent forum might make such decisions unenforceable.<sup>184</sup> The SIA's conclusion appears dubious.<sup>185</sup>

The simple answer to the SIA's fear would be to bring AAA arbitration under SEC oversight.<sup>186</sup> Neal Brown, a practicing attorney, along with Richard Shell and William Tyson, professors of law at the University of Pennsylvania's Wharton School of Law, argue for just such a proposal in a recent article.<sup>187</sup> Furthermore, they advocate the SEC's mandating a uniform procedural code for all arbitrations.<sup>188</sup> The authors suggest that the SEC should look to the Commodities Futures Trading Commission (CFTC) for guidance in amending the present SICA Code.<sup>189</sup> The CFTC has promulgated regulations to govern commodities markets disputes.<sup>190</sup> Two changes the authors recommend are: (1) requiring separately executed arbitration agreements with disclosure statements explaining the legal consequences of the agreement,<sup>191</sup> and (2) allowing the parties to select the arbitrators themselves with the aid of information concerning securities arbitrations the arbitrators were involved with in the past five years.<sup>192</sup> Moreover, Madelaine Eppenstein, a prominent customers' attorney from the New York law firm of Eppenstein & Eppenstein,<sup>193</sup> claims that one of several reasons customers believe AAA forums to be fairer is that the parties are able to engage in an arbitrator selection process which is much more expansive

181. See *Scher*, 723 F. Supp. 211, 213-14.

182. *Securities Firms Oppose SEC Bid to Give Investors More Flexibility on Arbitration*, *supra* note 41, at 16, col. 5-6.

183. *McMahon*, 482 U.S. at 238.

184. See *Securities Firms Oppose SEC Bid to Give Investors More Flexibility on Arbitration*, *supra* note 41, at 16, col. 6.

185. See *infra* note 199 and accompanying text.

186. See Brown, Shell & Tyson, *supra* note 162, at 34.

187. *Id.*

188. *Id.*

189. *Id.* at 34-35.

190. 17 C.F.R. 180.3(b)(2), (6) (1980).

191. The SICA and the NYSE have adopted very similar disclosure rules. See *supra* note 167.

192. Brown, Shell & Tyson, *supra* note 162, at 35-36.

193. The Eppensteins represented the *McMahons* both in the U.S. Supreme Court and the Second Circuit Court of Appeals, as well as representing *Anderson* in *Cowens*, 76 N.Y.2d 318, 559 N.Y.S.2d 225.

than the procedure at the SROs, after reviewing background information about potential arbitrators.<sup>194</sup>

It is questionable whether the courts will have any part in securities arbitration reform.<sup>195</sup> Although courts have consistently rejected the argument that pre-dispute arbitration agreements are adhesive contracts,<sup>196</sup> it may be time for courts to re-examine their rulings in light of pre-dispute agreements that continually narrow the forum choice to only particular SRO forums.<sup>197</sup> The SEC maintains that customers should have a choice of any SRO forum of which the brokerage house is a member.<sup>198</sup> Furthermore, David Robbins, a former arbitration director at the AMEX who now works for a New York law firm, has stated, "[i]t's bad enough that access to court is foreclosed, let alone a forum with no allegiance to the securities industry."<sup>199</sup>

On the other hand, the brokerage houses funding the SRO forums are beginning to feel the weight of the heavy financial burden of subsidizing the arbitration process.<sup>200</sup> The NASD, which handled 65% of the arbitration cases filed in SRO forums in 1989, spent \$10 million to fund the process—10% of its total budget—while collecting only three million dollars in fees.<sup>201</sup> Aggravating matters for the NASD is the fact that it hears many claims that arise out of securities transactions on other exchanges.<sup>202</sup> This is because many arbitration agreements give the customer a choice of various SRO forums should a dispute arise, and the NASD appears to be the forum of choice.<sup>203</sup> Moreover, one securities industry commentator notes that while there is a general sentiment among investors that AAA forums are fairer than SRO forums, there is also a feeling that of the two major forums, the NASD and the NYSE, the NASD is more hospitable to customers.<sup>204</sup>

The brokerage houses' posture towards AAA arbitration places them in a paradoxical situation. On the one hand, the brokerage houses want to escape the high cost of subsidizing the vast majority of customer disputes;<sup>205</sup> but on the

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194. Telephone interview with Madelaine Eppenstein of Eppenstein & Eppenstein in New York City (Mar. 28, 1991).

195. See Serota, *supra* note 5, at S112.

196. Katsoris, *supra* note 8, at 423 n.8.

197. See Comment, *supra* note 17, at 130-32.

198. See *SEC Urges Firms to Widen Arbitration Options to Include Independent Panels*, *supra* note 100, at 5, col. 4 (eastern ed.).

199. *Securities Firms Oppose SEC Bid to Give Investors More Flexibility on Arbitration*, *supra* note 41, § C at 16, col. 5.

200. *Street Eager for Arbitration Superforum*, *supra* note 9.

201. *Id.*

202. *Id.*

203. *Id.*

204. Wilson, *How to Fight Your Broker*, *NEWSWEEK*, Feb. 1, 1988, 43.

205. See *supra* notes 199-200 and accompanying text.

other hand, they are adamantly opposed to submitting to arbitration before the AAA—especially outside the city of New York.<sup>206</sup>

Furthermore, the situation becomes more enigmatic where an arbitration agreement limits available arbitral forums to only a few specific SRO forums. While such limitations are valid,<sup>207</sup> the SEC believes that customers should have the option for choosing an independent forum to arbitrate their disputes.<sup>208</sup> It appears that two main rationales for the enforceability of pre-dispute arbitration agreements noted in *McMahon* and *Rodriguez* are brought into conflict by these restrictive agreements: the FAA's expressed policy to make arbitration agreements enforceable just as any other contract, and the benefit of SEC oversight over the SRO arbitration process.<sup>209</sup>

## VII. A POSSIBLE SOLUTION

The customers' perception that SRO forums are inherently unfair, coupled with the brokerage houses' disenchantment with the increasing costs of funding the SRO forums, leaves some securities industry insiders and commentators calling for the creation of a single "superforum".<sup>210</sup> For SROs, a superforum offers the possibility of escaping the increasingly high cost of hearing arbitration claims against its member brokerage firms.<sup>211</sup> For the customers, a superforum allows them to escape arbitration in the brokerage houses' backyard.<sup>212</sup> An added advantage of a single forum would be to bring uniformity to a variety of rules that exist at different SRO forums and with the AAA.<sup>213</sup>

### A. The "Superforum"

If the superforum is to be a viable solution to the problems facing the current securities arbitration system, the structure and procedures of the new forum should incorporate many of the advantages of the more sophisticated SRO systems<sup>214</sup> and the perceived impartiality of the AAA.<sup>215</sup> The next section of this Comment will discuss considerations to be taken into account in developing an arbitration system capable of accommodating the concerns of both customers and brokers.

206. See *supra* notes 113, 152-74 and accompanying text.

207. See *supra* note 107 and accompanying text.

208. *SEC Urges Frims to Widen Arbitration Options to Include Independent Panels*, *supra* note 100.

209. *McMahon*, 482 U.S. at 226, 238.

210. Katsoris, *supra* note 8, at 383; *Street Eager for Arbitration Superforum*, *supra* note 9. See Brown, Shell & Tyson, *supra* note 162, at 33-34.

211. See *supra* notes 200-03 and accompanying text.

212. See Katsoris, *supra* note 8, at 475.

213. *Id.* at 476.

214. See Robbins, *supra* note 7, at 126-226.

215. Katsoris, *supra* note 8, at 473-75.

### B. Funding

One of the first issues facing a new superforum would be how to fund it.<sup>216</sup> David Robbins, former director of arbitration at the AMEX and now an attorney for a New York law firm, believes that the brokerage houses would still have to play a major role in its funding.<sup>217</sup> On the other hand, Constantine Katsoris, a professor at Fordham Law School and a leading expert on securities arbitration, has argued that a new forum should find a new means of funding.<sup>218</sup> Professor Katsoris believes independent funding would help insure that the new forum remains truly independent of pressures from either brokers or customers.<sup>219</sup>

Moreover, a problem with the SROs' continuing to carry the brunt of the funding burden is the risk of perpetuating the perception that the new forum, like its predecessor the SRO forums, is biased in favor of the brokerage houses.<sup>220</sup> Additionally, the SROs would most likely prefer not to subsidize a new superforum in full or in part because one of their main interests in a superforum is to escape the high cost of the present system.<sup>221</sup>

Professor Katsoris has suggested placing a surcharge on each securities transaction to be used to fund the new system.<sup>222</sup> This would offer the advantage of distancing the SROs and brokerage houses from the arbitral forum, as well as relieving them of the high cost of subsidizing it.<sup>223</sup> Another means of funding a new forum may be to adopt a fee system similar to that used by the AAA.<sup>224</sup> While this would raise the potential cost of arbitration to some customers, that risk seems inherent in the creation of a single forum.<sup>225</sup> Furthermore, as the AMEX window cases poignantly illustrate, many customers appear willing to pay the extra costs of arbitration before the AAA instead of an SRO.<sup>226</sup>

On the other hand, some of the fears of financing an independent forum may be overdrawn.<sup>227</sup> Professor Katsoris believes that creating a new superforum would lead to greater economies of scale that would ultimately lower the cost of

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216. *Id.* at 475.

217. *See Street Eager for Arbitration Superforum, supra* note 9.

218. *See Katsoris, supra* note 8, at 475.

219. *Id.* at 473.

220. Telephone conversation with Madelaine Eppenstein, *supra* note 194. *See also Street Eager for Arbitration Superforum, supra* note 9. In the article, David Robbins was quoted as saying "[t]he old boy network, which may exist in certain places should not be as prevalent . . . [b]ut there really would be no change in perception." Wall St. J., Aug. 24, 1990, § C at 1, col. 4.

221. *See supra* notes 200-03 and accompanying text.

222. Katsoris, *supra* note 8, at 475.

223. *Id.* *See supra* notes 190-91 and accompanying text.

224. *See supra* note 72 and accompanying text.

225. *See Street Eager for Arbitration Superforum, supra* note 9.

226. *See supra* notes 104-58 and accompanying text.

227. *See Katsoris, supra* note 8, at 475.

arbitration.<sup>228</sup> However, not all securities arbitration experts share this sentiment.<sup>229</sup>

### C. Arbitrators

Another problem facing a potential independent superforum is how to stock the new system with qualified arbitrators.<sup>230</sup> If the system does not have the funds initially to pay competent arbitrators, it may never get off the ground.<sup>231</sup> Obviously, present SRO and AAA arbitrators could serve in the new superforum.<sup>232</sup> Because the majority of securities arbitrations is handled by the SROs at this time, most of the available arbitrators would be SRO arbitrators.<sup>233</sup> While it may be argued that mainly using SRO arbitrators would perpetuate the perceived pro-brokerage bias of the old system,<sup>234</sup> the use of these arbitrators may not create any true bias problems. In the typical three arbitrator panel that hears most SRO arbitrations, the majority of the arbitrators will not be associated with the securities industry.<sup>235</sup>

### D. Rules for the New Forum

An important consideration for the proposed new forum would be choosing the appropriate rules for its proceedings. To start drafting rules from scratch would not make sense, when the SICA Code would provide a ready guide.<sup>236</sup> Arguably, it would be simplest and most prudent to adopt the present SICA code with necessary modifications.<sup>237</sup> The SICA rules are the product of years of experience of drafting rules to cover the over 25,000 SRO arbitrations to date.<sup>238</sup> Another factor in favor of adopting the SICA Code is the oversight provided by the SEC in the rules drafting process.<sup>239</sup>

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228. *Id.*

229. See *Street Eager for Arbitration Superforum*, *supra* note 9. Said Richard Ryder, editor of the Securities Arbitration Commentator, "Competition holds prices down better than monopolies." *Wall St. J.*, Aug. 24, 1990, § C at 17, col. 1.

230. *Id.*

231. *Id.*

232. Katsoris, *supra* note 8, at 475.

233. In 1988 and 1989 respectively, the AAA heard 495 and 440 securities arbitration cases. Friedman, *supra* note 75, at 2. In those same two years, SRO forums heard 6,101 and 5,403 cases respectively. *Arbitration Cases Over Securities Declined Last Year*, *supra* note 176.

234. See *Street Eager for Arbitration Superforum*, *supra* note 9.

235. See *supra* notes 79-82 and accompanying text.

236. Katsoris, *supra* note 8, at 477; see also Brown, Shell & Tyson, *supra* note 162, at 34-35.

237. Katsoris, *supra* note 8, at 477.

238. *Id.* at 476.

239. See *supra* note 77 and accompanying text.

### VIII. CONCLUSION

Now that the Supreme Court has greatly expanded the validity of pre-dispute arbitration agreements<sup>240</sup> and the brokerage houses have responded by increasingly limiting the arbitral forum to industry-subsidized forums,<sup>241</sup> the time has come to protect the customers' interest in arbitrating before a fair and efficient forum, free from industry bias. To insure fairness, customers should not be restricted to arbitrating only before SRO forums. This Comment has discussed two methods of accomplishing this goal of fairness. One option is for the SEC or Congress to require that the brokerage houses provide the customer with an option to arbitrate in an independent arbitral forum, namely the AAA.<sup>242</sup> While customers may welcome such a development, including an AAA alternative in arbitration agreements is probably no cure-all.<sup>243</sup> Brokerage houses are leery of AAA arbitrations, especially those conducted outside of New York City.<sup>244</sup> Furthermore, the AAA may not be able to handle the current crush of arbitration cases before the SROs.<sup>245</sup>

The other solution discussed in this Comment is to create a single forum for arbitrating customer grievances.<sup>246</sup> But the new forum would need to be independent of the industry influences which customers believe taint SRO forums.<sup>247</sup> Theoretically, the "superforum" solution could offer advantages benefitting both the customer, by providing a neutral forum, and the brokerage houses, by freeing them from the expense of subsidizing arbitrations.<sup>248</sup>

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240. See *supra* notes 1-3 and accompanying text.

241. See *supra* notes 104-60 and accompanying text.

242. See *supra* notes 170-85 and accompanying text.

243. Katsoris, *supra* note 8, at 476. Professor Katsoris points to two reasons why he believes the AAA is not a viable single forum for securities arbitration at this time: the lack of subsidization and the absence of SEC oversight.

244. See *supra* notes 155-60 and accompanying text.

245. *Id.*

246. See *supra* notes 210-35 and accompanying text.

247. See Katsoris, *supra* note 8, at 475.

248. *Id.* at 473-77.

Requiring SEC oversight over the superforum would help insure it is fair and efficient.<sup>249</sup>

The time for change appears to be drawing near.<sup>250</sup> The SEC is encouraging the brokerage houses to include the AAA as an option in arbitration agreements.<sup>251</sup> The brokerage houses are giving serious consideration to the formation of a single forum.<sup>252</sup> And finally, customers, increasingly frustrated by the use of restrictive pre-dispute arbitration clauses, should be eager for a change.<sup>253</sup>

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249. See generally Brown, Shell & Tyson, *supra* note 162, at 33-34.

250. See *Finding a Forum for Arbitration*, *N.Y. Times*, July 12, 1990, § D at 8, col. 3.

251. See *supra* note 178 and accompanying text.

252. See *Street Eager for Arbitration Superforum*, *supra* note 9.

253. See Bedell & Bosch, *supra* note 100, at 86-87; *Street Eager for Arbitration Superforum*, *supra* note 9.



